



HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT

SRI LANKA

Debt Management Reform Plan

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High-Level Summary Technical Assistance Report
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The *High-Level Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.

ABSTRACT: At the request of the Ministry of Finance (MoF) of Sri Lanka, a joint IMF-World Bank technical assistance (TA) mission team visited Colombo, Sri Lanka during February 20–March 3, 2023 to support the government in designing a Debt Management Reform Plan, with a focus on the reform of the debt management legal and institutional frameworks, public debt transparency, and the management of guarantees and on-lending.

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Background

At the request of the Ministry of Finance, Economic Stabilization and National Policies (MoF), a joint International Monetary Fund (IMF) - World Bank mission visited Colombo, Sri Lanka on February 20–March 3, 2023 to support the government of Sri Lanka on designing a Debt Management reform plan, focused on the legal framework, institutional arrangement, debt transparency, and management of government guarantees and on-lending. The Central Bank of Sri Lanka (CBSL) has made the decision to divest public debt management (PDM) responsibilities to focus on its primary mandate to promote price stability, requiring the vesting of a new mandate to the MoF. Establishing a consolidated Debt Management Office is a priority reform laid out in the 2022 interim budget and is a commitment under the IMF's Extended Fund Facility Arrangement and the World Bank's Development Policy Operation.

Summary of Findings

The existing legal framework for PDM is fragmented and lacks the basic elements. There are multiple laws on specified debt instruments, which cover loan agreements, T-bills, T-bonds, and government promissory notes, but the range of instruments that comprise public debt is not exhaustively captured. The term “government” is not defined in any of the primary laws on public debt, leaving ambiguity with regards to its coverage, especially on whether public sector entities beyond the budgetary central government are included. The legal framework is also unclear on whether extrabudgetary units are part of the central government for purposes of recording central government debt. There is no definition of the objective for managing public debt, nor a requirement to develop a medium-term debt management strategy (MTDS) and its approval by the highest government authority, thus the legal framework does not mandate the coherent management of the public debt.

The institutional framework for PDM is fragmented. Domestic debt issuance is managed by the CBSL, and external borrowing is conducted by the External Resources Department (ERD) of the MoF. Back-office functions are conducted at the Treasury Operations Department of the MoF and at the CBSL, while some middle-office functions are conducted at the CBSL. The fragmented institutional framework contributes to the lack of a coherent management of the public debt.

A wide range of central government debt is disclosed, but timeliness, coverage, and consolidation of information could be improved. While coordination mechanisms exist, there are duplication of processes and resulting outputs as a result of the fragmented debt management institutional arrangement. The last published MTDS was in 2019 and there is no published annual borrowing plan. Quarterly auction calendars and auction results are published, but direct issuances to the primary dealers and to the CBSL are not reported to the public and there are no press releases.

Guaranteed loans and on-lending of borrowed funds are used interchangeably by the government to provide financial resources to state owned enterprises (SOEs). There is no policy framework that defines when a guarantee or on-lending should take place based on an assessment of creditworthiness and quantification of the probability of default. CBSL and MoF reports present some data on guaranteed debt, but there are no publicly available data on the outstanding balance of on-lent loans. There are no documented procedures in place applicable to the oversight of guarantees and legal limits have been exceeded.

Summary of Recommendations

The mission provided recommendations on the (1) legal framework; (2) location of the new consolidated public Debt Management Office (DMO); (3) internal organization of the DMO; and (4) debt transparency and management of government guarantees and on-lending of borrowed funds.

1. *Legal framework for PDM.* The mission recommended introducing a new PDM law, which would establish the DMO and define its mandate. More broadly, the new PDM law would define the governance and accountability framework for the PDM from Parliament, who would delegate to the MoF the authority to borrow and issue guarantees on behalf of the state. The PDM objectives, set by Parliament would be operationalized by the development and implementation of an MTDS and an annual borrowing plan (ABP), consistent with the medium-term fiscal framework and the annual budget. The need for transparency would also be embedded in the PDM law, including annual reporting to Parliament on the progress of the debt management strategy.

2. *Location of the DMO.* The mission recommended that the DMO be established inside the MoF, consistent with sound practices in a vast majority of emerging markets and developing economies. The mission assessed that preconditions in Sri Lanka for establishing the DMO as a “separate statutory body” were not met and were unlikely to be in place for the foreseeable future. Preconditions include a stable macroeconomic environment, a well-developed domestic debt market, access to the international capital market, and well-trained staff in both the principal entity (MoF) and the agency. Regardless of the location, an MTDS approved by the Cabinet of Ministers is the key instrument that would strengthen the DMO’s operational independence.

3. *Internal organization of the DMO.* The mission considered two options for the internal organization of the DMO: including and excluding the multilateral and bilateral relationship management functions carried out by the ERD. The mission recommended that the DMO comprises a small group of specialized professionals narrowly focused on PDM functions, with the nonborrowing functions be retained at the ERD as a separate department.

4. *Public debt transparency and government guarantees and on-lending of borrowed funds.* The fragmented institutional arrangement and legal framework have led to the duplication of public debt databases and the recording and reporting of public debt. The issuance and management of guarantees and on-lending of borrowed funds lack a framework and control system. The new PDM law and consolidated institutional arrangement should help strengthen debt data management and unify debt reporting and institutionalize a policy for issuing and managing debt guarantees and on-lending, consistent with the overall government risk management framework.

The authorities agreed with the mission’s recommendations. As next steps, the authorities will begin drafting the PDM law and implement reforms that can be carried out ahead of the formal establishment of the new DMO. The drafting of the PDM law will need to be closely coordinated with the concurrent drafting of a new public financial management law. The mission stands ready to provide further technical assistance to support the authorities to implement the reform plan recommendations.